

Private Letter Ruling: Unitary business group changing method of accounting for income of members not using the common taxable year are not subject to limitation of net loss carryforwards of such members to year of change.

December 8, 1999

Dear:

This is in response to your letter dated November 29, 1999, in which you request a Private Letter Ruling on behalf of xxxxxxxxxxxxxxxxx. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of the enclosed copy of Section 1200.1120 appears to be contained in your request. The Private Letter Ruling will bind the Department only with respect to xxxxxxxxxxxxxxxxx for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither xxxxxxxxxxxxxxxxx nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them are as follows:

I. Requirements of the PLR Regulation

1. This PLR request is made on behalf of [xxxxxxxxxxxxxxxxxxx] Parent, as designated agent for the members of its unitary group.
2. This PLR request regards the application of the Illinois income tax laws.
3. This PLR request does not involve an alternative plan of proposed transactions or hypothetical situations.
4. This PLR request does not involve an identical issue that is reflected in Parent's return for an earlier period. Further, Parent, and its unitary group members, is not currently under audit by the Department.
5. Illinois case law and the Department's regulations are not dispositive of the subject of this PLR request.
6. To the best of the knowledge of Parent personnel, and to the best of my own knowledge, the Department has not previously ruled on the same or a similar issue for the taxpayer or a predecessor, or whether the Parent or any of its representatives previously submitted the same or a similar issue to the Department but withdrew it before the letter ruling was issued.
7. To the best of the knowledge of Parent personnel, and to the best of my own knowledge, there are no authorities contrary to the views reflected in this PLR request.

II. Issue Presented

At issue is whether any limitation is imposed on the utilization of Illinois net loss deduction ("NLD") of the subsidiaries of Parent for the "transitional" year described below which, effectively, reflects the combination of two months of the subsidiaries' taxable income and twelve months of the Parent's taxable income?

III. Ruling Requested

No limitation is imposed on the utilization of an NLD where a member of the combined group includes less than the full year's net income in the combined return. Thus, no limitation is imposed on the utilization of subsidiaries' NLD for the "transitional" year described below which, effectively, reflects the combination of two months of the subsidiaries' taxable income and twelve months of the Parent's taxable income.

IV. Statement of Facts

In accordance with Illinois Compiled Statutes ("ILCS") section 502(e) and Administrative Code ("Adm. Code") section 100.5265, a combined return has been filed by Parent, an Illinois taxpayer and the "controlling corporation" and "designated agent" of a unitary group for Illinois income tax purposes. The combined return has been filed reflecting the Parent's taxable year ended October 31st. The Parent's subsidiaries use a calendar taxable year and the combined return has reflected the combination of the subsidiaries' taxable income by combining 2/12ths of the taxable income for the calendar year ended prior to Parent's October 31 tax year end and 10/12ths of the taxable income for the calendar year ended subsequent to the October 31 year and. This method is referred to as "Method 2" by Adm. Code section 100.5265(b)(2). The combined return has also reflected the utilization of an Illinois net loss deduction ("NLD") carryforward, which includes NLD carryforward from the subsidiaries' pre-combination tax years.

To reduce the administrative tasks involved in combining the two different reporting periods, Parent proposes to reflect the subsidiaries' combination by combining the taxable income for the full 12 month calendar year that ends within the Parent's fiscal year. This method is referred to as "Method 3" by Adm. Code section 100.5265(b)(3). For example, by combining the subsidiaries' taxable income for the 1999 calendar year activities with the Parent's taxable income for the fiscal year ending October 31, 2000.

In accordance with Adm. Code section 100.5265(c), Parent proposes to attach a schedule to the combined return for the taxable year ended October 31, 1999 that discloses the change in the combination methodology as described above and adjusts for the difference between the total net income of the combined group for the years for which Method 2 was used and the total net income of the combined group that would have been reported had Method 3 been used. As a consequence of this change in the combination methodology, there will be a "transitional" return year, which, effectively, combines only two months of the subsidiaries' calendar year taxable income with the Parent's taxable income for its twelve-month fiscal year. (Hereafter, both the Parent and the subsidiaries will combine the taxable income from twelve months of operations.)

For the purpose of computing the above-mentioned adjustment resulting from the change to Method 3 and the related "transitional" year computation, the Parent will reflect the subsidiaries' NLD. As stated below, at issue is whether any limitation is imposed on the utilization of this NLD for the "transitional" year which,

effectively, reflects the combination of two months of the subsidiaries' taxable income and twelve months of the Parent's taxable income.

V. Analysis

As noted above, Adm. Code section 100.5265(b) provides for three alternative methods to effectuate the combination of combined group members with different taxable years. Further, Adm. Code section 100.5265(c) provides for a change in the combination method where the taxpayer discloses such change and takes into income the difference in net income that results from applying the new method to prior combined return years (as compared with the net income as previously computed). This re-computation of net income can involve the application of NLD carryforward amounts from pre-combination tax years. In turn, the differing tax years involved will result in the combination of at least one "short period" tax year with a full twelve-month tax year as a consequence of transitioning to the new reporting methodology. As stated above, at issue is the limitation, if any, imposed on the utilization of the NLD carryforward for purposes of computing the combined group's net income for the "transitional" year.

In general, ILCS section 207 provides for the determination of an NLD after applying all modification, allocation, and apportionment provisions. More specifically, ILCS section 207(a) provides:

If after applying all of the modifications provided for in paragraph (2) of Section 203(b), paragraph (2) of Section 203(c) and paragraph (2) of Section 203(d) and the allocation and apportionment provisions of Article 3 of this Act, the taxpayer's net income results in a loss, such loss shall be allowed as a carryover or carryback deduction in the manner allowed under Section 172 of the Internal Revenue Code.

Adm. Code section 100.2350 addresses the utilization of an NLD where a change in membership of the combined group occurs and provides in paragraph (a):

IITA Section 207 provides that the amount of Illinois net loss that is available as a carryback or carryover is determined after applying the allocation and apportionment provisions of Article 3. That Section does not limit the amount of Illinois net loss that may be carried into a given year. As a consequence, no such limitation shall apply. (emphasis added)

Based on the above, no limitation appears to be imposed on the utilization of an NLD in the carry year, regardless of whether a member of the combined group is including less than twelve months of net income. Moreover, this treatment appears consistent with prior rulings by the Illinois Department of Revenue that the federal separate return limitation year ("SRLY") rules are not applicable for purposes of utilizing an NLD.

Ruling

When a unitary business group includes a member using a taxable year that is different from the common taxable year of the group, 86 Ill. Adm. Code Section 100.5265(b) provides three different methods for determining "the separate company taxable income of that member used in computing the combined net income of the combined group." Section 100.5265(c) provides:

Each taxpayer having a taxable year different from the common taxable year of its combined group may separately elect which of the methods listed in subsection (b) above it will use for the first combined return in which such taxpayer is a member the combined group. Once a member has used one of those methods for a combined return, that method shall be used for all subsequent combined returns of such group unless:

- 1) the change in method is disclosed in an attachment to the first combined return for which a different method is used;
- 2) the attachment shows, for each year in which the member changing its method has been a member of the combined group, including the year in which the new method will be used:
 - A) the net income of the combined group computed with such member using its former method;
 - B) the net income of the combined group computed with such member using the new method; and
 - C) the totals of such combined net incomes as computed using each method; and
- 3) any excess of the total amounts of combined net income computed using the new method over the total amounts computed using the old method must be added to (or any deficiency be subtracted from) the net income of the combined group for the year in which the new method is first used.

In the situation described in your request, the combined group of which xxxxxxxxxxxxxxxxxxxx is designated agent uses an October 31 taxable year. The group will change its method of determining the incomes of those members who use calendar taxable years that are included in the combined net income of the group from "Method 2" described in Section 100.5265(b)(2) to "Method 3" described in Section 100.5265(b)(3). Under Method 3, the combined group will include in its combined taxable income the entire incomes of the calendar-year members for the taxable years of those members that end within the common taxable year of the combined group. However, under Section 100.5265(c), for the first year in which Method 3 is used, the combined group will also subtract from its combined net income the excess of the amounts of the calendar-year members' incomes included in combined net income in prior years using Method 2 over the amounts that would have been included in combined net income during those years using Method 3. This subtraction should be equal to the incomes of the calendar-year members for the first 10 months of their respective taxable years ending in the year of the change, since that income was included in combined income of the group in the year prior to the year of change using Method 2 but would not have been so included using Method 3. The net effect is to tax the combined group as if Method 3 had been used in all years.

There is no statutory or regulatory authority that expressly limits the amount of the Illinois net losses of the calendar-year members that may be used by the combined group in the year of the change to Method 3. There is also no statutory or regulatory authority that limits the amount of the Illinois net losses of the calendar-year members that could have been used to offset the combined net income of the group in earlier years had Method 3 been used in those years. Also, under the regulations, the entire amount of income earned by each of the calendar-year members during its taxable year ending in the year of change will be included in the combined income of the group in that year. The fact that the combined income will also be reduced by the adjustment required in Section 100.5265(c) does not change that fact.

Accordingly, because there is no statutory or regulatory provision that limits the use of the calendar-year members' Illinois net losses in a combined year merely because the method used to determine the amount of the calendar-year members' income included in combined net income is changed in that year, and because the full amount of the income of each of the calendar-year members is in fact included in combined net income in the year of the change, there is no basis for ruling that the net losses of the calendar-year members must be limited in that year. Unless some other facts not discussed in your request would require limitation of the losses, the combined group may use the Illinois net loss carryforwards of the calendar-year members in their entirety in the year of the change to Method 3, provided, of course, that the combined net income of the group may not be reduced to less than zero in that year as the result of such carryforwards.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Very truly yours,

Paul Caselton
Deputy General Counsel -- Income Tax